ANALYSIS OF ORIGINAL BILL

Author: Briggs | Analyst: Marion Mann DeJong | Bill Number: AB 462

Related Bills: SB 31 (1997/98) | Telephone: 845-6979 | Introduced Date: 02/16/1999

Attorney: Doug Bramhall | Sponsor:

SUBJECT: Warehousing & Distribution Investment Credit

SUMMARY

This bill would create a credit of 6% of the qualified cost of qualified property for taxpayers engaged in specified warehousing and distribution activities in a qualified facility. The general structure of this credit is based upon the Manufacturers' Investment Credit (MIC).

EFFECTIVE DATE

As a tax levy, the bill would become effective immediately upon enactment. The bill specifies that the credit would apply to costs paid or incurred in taxable or income years beginning on or after January 1, 1999, and would sunset when the MIC sunsets.

SPECIFIC FINDINGS

Existing state and federal laws generally allow a depreciation deduction for the obsolescence or wear and tear of property used in a business or investment property. The property must have a limited, useful life of more than one year and includes equipment, machinery, vehicles and buildings, but excludes land. Property is assigned to specific classifications related to the number of years of its useful life. The property then may be depreciated over the number of years of its useful life (recovery period).

Existing state and federal laws allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer's business.

Existing state law allows taxpayers to use various credits such as the MIC against tax. The **MIC** allows qualified taxpayers a credit equal to 6% of the amount paid or incurred after January 1, 1994, for qualified property that is placed in service in California.

For purposes of the MIC, a qualified taxpayer is any taxpayer engaged in manufacturing activities described in specified codes in the SIC Manual. Qualified property is any of the following:

1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code and used primarily:

- for manufacturing, processing, refining, fabricating or recycling of property;

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- for research and development;
- for the maintenance, repair, measurement, or testing of otherwise qualified property; or
- for pollution control which meets or exceeds state or local standards.

2) The value of any capitalized labor costs directly allocable to the construction or modification of the property listed in #1 above or for special purpose buildings and foundations listed in #3 below.

3) Special purpose buildings and foundations that are an integral part of manufacturing, refining, processing or fabricating, or research and storage facilities that are part of the process, which are used by qualified persons performing manufacturing activities described in specific codes relating to computer, accounting, and office machines, electronic equipment and accessories, biotech or biopharmaceutical activities, semiconductor equipment manufacturing activities and certain aerospace manufacturing activities.

The MIC explicitly excludes certain types of property from the definition of qualified property, including equipment used in the extraction process, furniture, facilities used for warehousing purposes after completion of the manufacturing process, inventory, equipment used to store finished products that have completed the manufacturing process, and tangible personal property used in administration, general management, or marketing.

The MIC provides a variety of special rules for costs paid pursuant to a binding contract and leased property. The credit may be carried over until exhausted, for a maximum of eight years. For small businesses, this carryover period is extended to ten years. The taxpayer must recapture any credit previously allowed if the property is removed from California, disposed of to an unrelated party or converted to an unauthorized use within one year from the date the property is first placed in service in California.

The MIC will become inoperative on January 1, 2001, or on the January 1 of the earliest year after 2001 if the total employment in manufacturing in this state does not exceed by 100,000 jobs the total employment in manufacturing in this state on January 1, 1994. The Employment Development Department (EDD) is required to report to the Legislature annually on this determination.

Certain “new businesses” (as defined) may claim an exemption from sales and use tax instead of the MIC. The existing sales and use tax law also allows a taxpayer to claim a refund for the sales or use tax that was paid on the purchase of qualified property rather than claiming the MIC (with certain limitations as to timing and amount of the refund).

This bill would create a credit equal to 6% of the qualified costs of qualified property, based generally on the MIC, for taxpayers engaged in qualified activities (warehousing or distribution activities) in a qualified facility. To avoid recapture, the taxpayer would be required to have a net increase of one or more full-time employees per 3,000 square feet of qualified facility within 12 months of acquiring or expanding that qualified facility.

“Qualified activities” would mean activities that continue the manufacturing process or otherwise prepare products for sale, or services that may include, but are not limited to: bulk breakdown or repackaging, bundling, handling, sorting, racking, moving, processing, storing, couponing, conversion, assembly, blending, treating, repairing, or reconstructing to meet final product requirements prior to shipping for retail consumption.

A “qualified facility” would mean a new or expanded facility, located in this state, owned or leased by the taxpayer in which activities of the taxpayer are primarily qualified activities. “New or expanded facility” would mean the increase in square footage of all facilities owned or leased by the taxpayer in this state in which qualified activities are performed.

For a facility to be qualified, the taxpayer must increase the square footage in which the taxpayer performs warehousing and distribution activities by at least 3,000 square feet. A qualified facility would not include an existing warehousing or distribution facility used by any taxpayer within the six-month period prior to acquisition by the taxpayer. Notwithstanding the "primarily" standard applicable to determining whether a facility is a "qualified facility" under the bill, a qualified facility would not include a facility in which retail sales activities are also performed.

“Qualified property” would be tangible personal property and capitalized labor costs allocable to such property that is used in qualified activities and that is used primarily for the handling, movement, and storage of inventory in a qualified facility. Only property primarily used in the new or expanded facility would qualify for the credit; property primarily used in the existing facility would not qualify.

As with the MIC, the taxpayer would be required to recapture the credit if the property is removed from this state, disposed of, or used for an unqualified purpose within one year. In addition, the credit would be recaptured if the taxpayer failed to increase the number of full-time employees at the qualified facility by at least one per 3,000 square feet of qualified facility within 12 months of acquiring or expanding the qualified facility. Full-time employees would be computed by using a full-time equivalent formula. The taxpayer would be required to maintain the overall level of employment in California, in addition to the increase of one employee per 3,000 square feet. The job requirement would apply only to the new or expanded portion of the facility. Thus, if a taxpayer has a 3,000-square-foot building and expands to 6,000 square feet, only one new job would be required.

The credit would be available only for taxable or income years that the MIC is available; thus, if and when the MIC is repealed, this credit also would be repealed. The taxpayer would be prevented from claiming both this credit and the MIC with respect to any item of qualified property. However, as with the MIC, taxpayers would be able to claim this credit and the enterprise zone sales or use tax credit. In addition, the credit would be carried forward for eight years, or ten years for small businesses, as with the MIC.

Policy Considerations

This bill would raise the following policy considerations:

- Although the bill would require the taxpayer to increase the number of jobs within 12 months of acquiring or expanding the warehousing or distribution facility to retain the credit, the bill would not require the taxpayer to maintain that level of employment after the 12-month period. A taxpayer could subsequently get a credit for the purchase of labor-saving equipment that resulted in the loss of jobs.

- The general definition of "qualified facility" contemplates a taxpayer "newly acquiring" additional space. However, “qualified facility” does not include a facility if *any* taxpayer performed qualified activities at that location during the preceding six months. Thus, a taxpayer can acquire new space, which was previously not used for any purpose, and it qualifies for the credit. However, if that same taxpayer acquires space that is new to that taxpayer (and which increases his qualified activities in this state by 3,000 square feet) but which was previously used by an unrelated taxpayer as a warehouse or distribution facility, it would not qualify.

- The credit added by this bill would extend to activities specifically precluded from qualification under the MIC since they are outside of the actual manufacturing process (i.e., warehousing and distribution.

Implementation Considerations

Implementation of the provisions of this bill would occur during the department’s annual system update.

Technical Considerations

Amendments 1 and 2 would clarify if the property would qualify for both this credit and the MIC that the taxpayer may claim only one of the credits with respect to that property. In addition, these amendments would delete a reference to an expired credit.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department’s costs.

Tax Revenue Estimate

The estimated revenue impact of this bill is shown in the following table:

Revenue Impact of AB 462 as Introduced February 16, 1999 Effective 1/1/99, Assumed Enacted After 6/30/99 ($ Millions)		
1999-00	2000-01	2001-02
($17)	($26)	($30)

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

Tax Revenue Discussion

The revenue impact of this bill would be determined by qualified investment amounts and liabilities of affected taxpayers. Qualified investment was estimated from U.S. Department of Commerce data capturing nationwide manufacturers' investment in tangible personal property used in warehousing and distribution activities. The national amounts were adjusted to approximate California's share of investment by applying the ratio of California employment to national employment (11.4% in 1994). This amount was grown to the out years by applying Department of Finance projected growth rates. The first year amount, 1999, was discounted to account for expenditures associated with binding contracts entered into prior to 1999. All investment amounts were adjusted to approximate capitalized labor directly associated with qualified investment (i.e., self-constructed property and installation of purchased equipment). These steps provide an approximation of the total cost of tangible personal property used in warehousing and distribution facilities.

The next step in this analysis is adjusting the base amounts to take into account the required expansion of space and employment. This estimate applies only to tangible personal property (machinery and equipment) used in warehousing and distribution activities (i.e., this estimate does not include the structure or other real property used in warehousing and distribution activities). Credit usage rates were estimated from tax return information.

BOARD POSITION

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 462
As Introduced February 16, 1999

AMENDMENT 1

On page 10, modify lines 28 through 33 as follows:

(i) If the qualified taxpayer is allowed a credit for any item of qualified property pursuant to this section and Section ~~17052.15 or 17053.49,~~ 17053.49 only one credit shall be allowed to the qualified taxpayer under this section or Section ~~17052.15 or~~ 17053.49 with respect to that qualified property.

AMENDMENT 2

On page 19, modify lines 15 through 19 as follows:

(i) If the qualified taxpayer is allowed a credit for any item of qualified property pursuant to this section and Section ~~23612.6 or 23649,~~ 23649 only one credit shall be allowed to the qualified taxpayer under this section or Section ~~23412.6 or~~ 23649 with respect to that qualified property.